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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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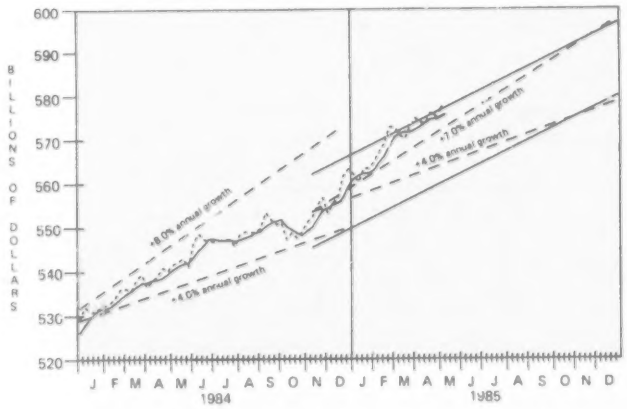
At The Federal Reserve . . .

Despite widespread expectations that the Federal Reserve is about to ease monetary policy, so far at least these hopes have apparently been dashed. To a large extent, this hesitancy stems from the mixed array of business signals being given off by the economy, fears that the rate of inflation may have finally begun to creep higher and still overly rapid M1 money supply growth. There is no doubt that the pace of today's business expansion has indeed slowed—and already has come to a virtual halt for the manufacturing sector of the economy. However, several members of the Fed's Board of Governors have offered widely differing views on both the health of the economy and the appropriate stance of policy—views which will ultimately shape the outcome of this week's Federal Open Market Committee meeting.

While most observers agree that the top policy priority at the Fed is to keep the business expansion on track, pronounced disagreement exists as to where the economy is actually headed. Depending on which day it is, the government statistics mill is either releasing or revising numbers which support almost any view of the economy—ranging from healthy, albeit more modest growth, to so-called "growth recession", to, for some at least, economic contraction. This is because while recent trends in such indicators as consumer spending, auto sales and housing starts point toward an expanding economy, those in such areas as industrial production, factory orders and manufacturing employment—all of which have been soggy since last summer—don't.

Although these numbers fit the general pattern of an economy increasingly split down the middle between a strong, consumption-oriented side and a weak, production-oriented side, it is not all that clear what should be done about it. Since the dichotomy largely reflects the growth-inhibiting effects of a widening trade deficit, which has been years in the making, and the escalating challenge of imports to corporate America, near-term changes in monetary policy, or even lower interest rates for that matter, may not do all that much to remedy the situation. To be sure, lower rates of interest should boost consumer and business confidence. But it is uncertain whether they would remove any of the luster of the dollar in the foreign exchange markets or prompt significant rebounds in such hard-pressed industries as agriculture, energy and steel, to name just a few.

MONEY SUPPLY, M1
FOUR-WEEK MOVING AVERAGE (LINE) VS. WEEKLY FIGURES (DOT)



. . . A Policy Dilemma Arises

Nor do inflation rate trends provide clear-cut clues to the appropriate course of policy—to either credit market participants or policymakers for that matter. To some, the sharp increases in the rate of rise in consumer prices in March and producer prices in April, not to mention the nearly 5½ percent annual rate rise in the GNP deflator in the first quarter, are the opening shots of a deteriorating inflation rate outlook. This implies that the Fed must remain cautious, and temper any move toward ease. However, since a large chunk of the recent rise in the rate of consumer and producer price inflation has been due to a steep upturn in motor gasoline prices—which have already begun to level off—a sustained acceleration in price inflation is unlikely. In fact, as long as the rise in labor costs, which constitute two thirds of all production costs, remains in check, so, too, will the price indexes.

And, here, the news remains good. For example, collective bargaining agreements reached in the first quarter call for initial year wage increases of less than three percent, while the increase in average hourly earnings in the January-March period stood below four percent. These trends hardly point

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toward higher rates of inflation. What is more, despite the March-April uptick in inflation rates, consumer prices during the most recent 12-month period are still advancing at about the same four percent rate that was posted in 1984 as a whole, while producer prices have risen by less than one percent over the most recent 12 months. This suggests that concern over inflation is unlikely to preclude a turn toward ease.

What To Do Next?

If neither business nor price trends provide clear-cut clues to what the Fed should or will do, looking at money supply developments won't help all that much either. For one thing, the M1 money supply has dropped in six of the last ten weeks and currently stands within the wider target bands of permissible money growth—suggesting some room for ease. But over the past 13 weeks, M1 expanded at a nine percent annual rate and is some $5.5 billion above the top end of its narrower four to seven percent, 1985 target cone—suggesting less room for accommodation (see chart on page 1). For another, while the growth of the broader money numbers, M2 and M3 has also been weak recently, it is quite possible that the stepped-up pace of individual income tax refunds may soon bolster their growth, as such refunds find their way into such M2 accounts as money market funds.

To be sure, such contradictory trends in the business, price and money numbers have complicated the

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/15/85	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	173.233	– 8.062	+12.111
Loans to Depository Inst.	1.393	+ .759	– 3.220
Float	.574	– .122	+ .563
Total Reserve Bank Credit	187.967	– 7.625	+13.092
Treasury Deposits with Federal Reserve Banks	6.883	– 5.674	+ 3.362
Currency in Circulation	182.900	+ .985	+10.732
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	118.116	+ .605	+ 3.738
	5/8/85		
Member Bank Reserves:			
Total Reserves Held	40.550	– 1.351	+ 3.682
Excess (Deficiency)	.722	– .170	+ .130
Net Free Reserves	.165	– .335	+ .576
		% Change Since Three Months Ago*	% Change Since Year Ago
Monetary Aggregates †			
M1 (5/6/85)	577.6	+ 9.1‡	+ 6.5‡
M2 (April '85)	2,427.0	+ 4.7	+ 8.3
M3 (April '85)	3,057.5	+ 4.9	+ 9.7
Domestic Nonfinancial Debt (4th Q'84)	5,970.8	+ 14.4	+ 13.6

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 5/17/85	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.40%	7.59%	7.83%
* Federal Agencies	7.84	8.15	8.50
* Project Notes–Taxfree (46% Taxable Equivalent)	9.04	9.07	9.26
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	7.95	8.12	8.55

‡ Finance Company Paper–Prime

5- 14 days	7.85%
15- 29 days	7.85
30- 59 days	7.80
60- 89 days	7.90
90-179 days	7.95
180-239 days	7.95
240-270 days	7.95

‡* Bankers' Acceptances

Jun.	7.85%
Jul.	7.85
Aug.	7.85
Sep.	7.85
Oct.	7.85
Nov.	7.85

‡ Industrial Paper–Prime

30- 89 days	7.85%
90-120 days	7.85

†Federal Funds Effective Rate 8.24%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'85	$ 3,820	$ 3,759	$ 3,553
Gross National Product (1972 Dollars)*	1st Q'85	$ 1,668	$ 1,662	$ 1,611
Percent Change, Annual Rate	1st Q'85	1.3	4.3	10.1
Change in Consumer Prices*	Mar '85	6.0%	3.6%	3.6%
Change in Producer Prices*	Apr '85	3.6%	2.4%	0.0%
Civilian Employment (Thousands of Persons) †	Apr '85	106,945	107,119	104,402
Unemployment as % of Civilian Labor Force †	Apr '85	7.3%	7.3%	7.8%
Personal Income*	Mar '85	$ 3,156	$ 3,140	$ 2,941
Leading Indicators Composite Index (1967=100)†	Mar '85	167.1	167.5	167.2
Industrial Production Index (1967=100) †	Apr '85n	165.4	165.8r	162.1
Net Change in Consumer Installment Credit †	Mar '85n	$ 8.34	$ 9.04r	$ 5.93
U.S. Merchandise Trade Balance †	Mar '85	–$ 11.05	–$ 11.45	–$ 10.27
Plant and Equipment Expenditures*	2nd Q'85	$388.86(a)	$380.05(a)	$348.34
Private Housing Starts (Thousands of Units)*	Apr '85n	1,913	1,883r	1,949
New Construction Expenditures*	Mar '85	$ 324.2	$ 323.8	$ 309.7
Total Business Inventories †	Mar '85n	$ 578.2	$ 578.9r	$ 538.8
Total Business Sales †	Mar '85n	$ 420.2	$ 418.7r	$ 404.6

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

tasks of those charged with the conduct of monetary policy. Which in itself is not unusual, given the fact that economic indicators usually do turn mixed at this stage of the business cycle. But what is unusual this time around is that few capacity constraints currently exist, price pressures are virtually absent, credit is readily available and interest rates are trending lower—factors which make 1985 look more like the first year of recovery from preceding postwar recessions, rather than the third. If the past was any guide, the central bank would be preparing a turn toward restraint, not ease and the business expansion would be winding down.

Given recent business and price statistics, a switch toward restraint is neither appropriate nor necessary. Which essentially leaves two choices at the Fed's policy-setting FOMC meeting: namely, put further initiatives on hold, and await more convincing economic trends, or ease, cutting the discount rate and trimming the cost of credit. And, while there would seem to be little risk associated with the latter course of action—and substantial benefit if it managed to dampen the dollar's external value—choosing the former course may entail the greater hazard of turning today's economic slowdown into tomorrow's recession. Since the Fed will seek to avoid this at virtually all costs, it would be prudent to look for an overt move toward ease in the not too distant future—a policy which would be more successful if done in tandem with the central banks of other industrial countries. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (5/1/85)	155,443	– 1,215	+12,491
New York City (5/8/85)	33,842	+ 296	+ 4,103
Commercial Paper (5/8/85)	257,501	+ 1,216	+47,099

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/1/85)	254,921	+ 1,177	+ 15,895
New York City (5/8/85)	62,552	+ 489	– 425

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/1/85)	675,049	+ 7,324	+ 66,151
New York City (5/8/85)	147,778	– 1,215	+ 12,557

Financial Markets

	Friday 5/17/85	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.64%	– .34	– 2.42
180-Day Bills†	8.00	– .31	– 3.05
Longest Bills†	8.42	– .29	– 3.33
Recent Issues:			
9 3/4s 4/30/87	9.34	– .26	
11 1/4s 3/31/89	9.98	– .30	
11 1/4s 5/15/95	10.84	– .19	
11 1/4s 2/15/15	11.05	– .13	
Municipals:			
Bond Buyer—20 Bond Index* (5/16/85)	8.86%	– .25	– 1.50
Blue List Total ($ Million)	$1,752	+ $ 73	+ $186
30-Day Visible Supply ($ Million)	$2,873	– $ 52	+ $129
Total	$4,625	+ $ 21	+ $315
Corporates:			
Moody's Aa Composite (5/16/85)	12.36%	– .23	– 1.87
30-Day Visible Supply ($ Million)	$1,175	+ $540	+ $ 45
Stocks:			
Dow-Jones Averages:			
Industrials	1,285.34	+ 11.16	+ 151.55
Transportation	622.56	+ 5.53	+ 147.97
Utilities	164.75	+ 5.02	+ 37.44
65 Stocks	529.89	+ 6.44	+ 88.68
Standard and Poor's 500 Stocks	187.42	+ 3.14	+ 31.64
N.Y.S.E. Composite Index	108.48	+ 1.84	+ 18.92
N.Y.S.E. Avg. Daily Vol. for Week (000's)	102,796	– 5,084	+ 19,892

* 46% Taxable equivalent 16.41%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/17/85	Week Ago
Overnight	8.06%	8.06%
1 month	8.06	8.06
3 month	8.19	8.25
6 month	8.44	8.56
1 year	8.94	9.19
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	10.60%	11.10%
Long Term (7 to 15 yrs.)	10.90	11.30

FOREIGN EXCHANGE SPOT RATES

New York Opening (5/17/85)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01612	62.0450
Canada	.7297	1.3705
Denmark	.08957	11.1650
France	.1066	9.3850
Germany	.3247	3.0800
Italy	.0005092	1964.00
Japan	.003987	250.83
Mexico	.003906	256.00
Netherlands	.2876	3.4765
Switzerland	.3865	2.5875
U.K.	1.2625	.7921

Great golf! Great cause! Great price!

The Manufacturers Hanover Westchester Classic will be held at the Westchester Country Club in Harrison, N.Y., June 3-9, 1985.

- Tickets for the Sports House and Grounds for 7 days—$60. Grounds only—$45. Monday and Tuesday (practice rounds)—$5 or $3 per day. Wednesday (the Pro-Am)—$10 or $6. Thursday, Friday, Saturday, Sunday—$18 or $15 each day.
- Scott Simpson, defending champion and other top pros from the PGA Tour, will compete for $500,000 in prize money.
- Proceeds help support the following area hospitals: United, Lawrence Auxiliary, New Rochelle, Northern Westchester, Phelps Memorial, St. Agnes, St. John's, St. Joseph's, St. Vincent's, Blythedale Children's, Greenwich, Mount Vernon, White Plains, Yonkers General.
- Tickets on sale at all these hospitals through June 2, thereafter at the gate. To charge with MasterCard or VISA call 212-808-8513.
- For more information call (914) 967-5356.

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SERVICE, INC.
4520 EAST-WEST HWY., SUITE 800
WASHINGTON, DC 20014